arrangements have ever been worked out. The purported contractual agreements cited by GTE, and the alleged decision by AT&T to put its joint venture efforts "on hold" pending review of the MediaOne acquisition, are inventions of GTE. The reality is that AT&T, despite its vigorous and still-ongoing efforts to negotiate joint ventures with numerous cable companies, has so far been unable to overcome the many difficulties that Applicants identified in their Public Interest Statement (pp. 31-32) and explain further in the attached declarations of Terrell Wingfield, Douglas Holmes and Professors Ordover and Willig.[38]

Any joint venture that contemplates the provision of services by one party over the facilities of another party raises difficult issues that are likely to lead to protracted negotiations.[39] And, in the current environment of rapid and increasingly unpredictable evolution and convergence in technologies and consumer demands, reaching agreement on a joint venture contract for the provision and marketing of telephony and other services over cable is inherently and especially difficult.

The attractiveness of a joint venture or other contract as a substitute for vertical integration by merger depends largely on two factors: (1) the amount of contract-specific investment that each party must make in the contract, and (2) the ability of the parties to

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[38] *See* Declaration of Terrell Wingfield, Jr. ¶¶ 3-10 ("Wingfield Decl."); Holmes Decl. ¶¶ 4-7; Ordover/Willig Decl. ¶¶ 53-65.

[39] For example, TCG needed 18 months to negotiate joint venture agreements with unaffiliated cable companies to use their fiber facilities to provide local exchange and exchange access services to large business customers, even though the cable companies had never developed a large business customer strategy, those negotiations did not contemplate the sharing of cable coaxial facilities to the customer, and technological convergence was not a major issue. *See* Wingfield Decl. ¶ 7.

negotiate a "complete" contract – *i.e.*, one that anticipates and specifies the parties' rights and duties under all circumstances.[40]

Where contract-specific investments are insignificant, businesses typically do not need to merge with their suppliers or customers.[41] The existence of significant contract-specific investments, however, creates the risk that one party may appropriate some or all of the other party's investment when the costs or benefits of performing the contract change enough after the contract is signed to render performance under the contract unprofitable.[42]

The ability of joint venturers to contract around the risk of appropriation of contract-specific investment is limited by the powers of human foresight. The more unpredictable and uncertain the economic and technological environment, the more inadequate the contractual safeguards are likely to be. As a result, when a vertical supply relationship requires substantial contract-specific investment in an uncertain economic environment, vertical integration by merger is likely to be the preferred alternative to contracting. Requiring market participants in these circumstances to obtain critical inputs through contracts rather than merger is likely to result in underinvestment and insufficient new entry.[43]

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[40] Ordover/Willig Decl. ¶ 54. Contract-specific investment refers to expenditures (1) which a company must make to perform its obligations under a contract, or to receive the benefits of the other party's performance, but (2) which cannot be recovered should the company terminate the contract before full performance by the other side. Examples of such investment include the expenses of promoting or marketing a trade name controlled by the other party, training personnel in the use of a product or process that is proprietary to the other party, or acquiring equipment or supplies that are useable only with the other party's goods or services. *See* Ordover/Willig Decl. ¶¶ 55-58.

[41] *Id.* ¶ 56.

[42] *Id.* ¶¶ 57-58.

[43] *Id.* ¶ 59.

The rollout of telephony, Internet and other new services over cable networks requires large contract-specific investments. These include the costs of research and development, licenses and permitting, acquisition of real estate and capital assets, installation of cable and customer premises equipment, marketing and advertising, and staffing of customer care centers. Many of these investments, once made, are contract-specific (in the sense that they could not be redeployed elsewhere by a party that withdrew from the project) and sunk (in the sense that they could not be recovered even upon termination of the project).[44]

Even more fundamentally, technologies and services are rapidly evolving and converging; hence, no one can reliably predict what business models, service offerings or technologies are likely to emerge as successful even over the next few years. As Mr. Wingfield and Mr. Holmes explain, this uncertainty makes it extremely difficult for a cable company that owns facilities potentially capable of providing multiple existing and future services, and a telephone company that wants to use those facilities to compete with the offerings of an ILEC (whose facilities have multiple uses under one ownership), to agree in advance on limits on the services that the telephone company will offer and the amount of cable bandwidth it may use.[45]

The cable company will, of course, insist on some limits – an arrangement free of limits that encouraged a venture only partly owned by the cable company to compete directly with the cable company's 100%-owned core business would surely incur the wrath of shareholders.[46] And it is far too early to predict reliably which services – telephone, video, interactive online or

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[44] *Id.* ¶ 60.

[45] *See* Wingfield Decl. ¶¶ 6-9; Holmes Decl. ¶ 6.

[46] *See* Wingfield Decl. ¶ 8; Ordover/Willig Decl. ¶ 62.

other – will achieve the greatest commercial success, and thus how much of the cable bandwidth should be allocated to each service.

At the same time, AT&T is properly concerned that contractual limitations that might be imposed on the basis of imperfect information today could have the unintended effect of hampering the ability and flexibility of the joint venture to respond to offerings of the ILECs that may flow from technology or other advances.[47] How, for example, could a joint venture limited to plain old telephone service hope to compete with a successful ILEC videophone offering?[48] In short, although flexibility is key to the joint venture's competitive success, the enormous contract-specific costs at issue make it imperative that, as between the joint venturers, rights and obligations be firmly and explicitly established at the outset.

As a result of these and other problems, AT&T has, despite discussions with a number of unaffiliated cable companies (as well as some in which AT&T holds an interest), to date obtained only a letter of intent to form a joint venture with Time Warner. Even if ultimately consummated, that joint venture would, of course, provide no competitive benefits to consumers in MediaOne's service areas. In any event, AT&T and Time Warner have been unable to reach agreement on actual joint venture terms, and the 90-day "drop dead" date specified in the letter of intent for the completion of all negotiations has long since expired. Although AT&T and Timer Warner continue to negotiate, and AT&T sincerely hopes to be able to offer consumers

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[47] *See* Wingfield Decl. ¶ 8.

[48] *See* Ordover/Willig Decl. ¶ 63.

across the nation an alternative to ILEC service, it remains uncertain whether, and to what extent, joint ventures will ultimately prove feasible.[49]

More to the point, MediaOne considered proceeding with a telephony joint venture, and ultimately determined that a full merger with AT&T was the best way to obtain the complementary resources necessary to maximize its competitive potential.[50] While AT&T will continue to pursue all reasonable opportunities to provide consumers nationwide with a facilities-based local service alternative to the ILECs, the strategy that promises the greatest and quickest benefits to consumers in the MediaOne service areas is the Merger of AT&T and MediaOne.

C. The Commission Should Give No Weight To Speculation That AT&T Might Abandon Its Plans To Offer Telephony And Other Services Over MediaOne's Cable Network.

The incumbents' suggestion that the Commission should ignore the competitive benefits of the proposed Merger because AT&T and MediaOne have failed to produce sufficient "evidence" or "commitments" that they will carry through their planned entry into cable telephony is equally unfounded.[51] Even GTE and SBC, the two sponsors of this proposal, do not take it seriously: along with other ILECs, they have rushed to market DSL and more competitive telephony offerings since AT&T announced its proposed mergers.

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[49] *See* Wingfield Decl. ¶¶ 3-5. With respect to Comcast, AT&T has signed only what is in effect an option that gives Comcast the right to opt-in to another cable company's agreement when, and if, AT&T succeeds in forming two cable telephony joint ventures. To date, Comcast has declined AT&T's overtures to work now toward a joint venture between Comcast and AT&T. *See id.* ¶ 4.

[50] *See* Holmes Decl. ¶ 4.

[51] *See* SBC at 48; GTE at 67.

Indeed, in their pleadings here, GTE and SBC concede that the very idea that AT&T would not follow through on its commitment to invest in local telephone competition following the Merger "is simply not credible."[52] In SBC's words, AT&T, having invested $60 billion to obtain facilities-based access to consumers in MediaOne's service areas, "*must* . . . press forward with its investment in local telephone competition" through cable telephony.[53] Likewise, the Commission has previously found that the magnitude of the investment involved in such a Merger gives AT&T "an obvious incentive to follow through on [its] announced plans" to aggressively deploy, market and support local telephony and online services over its cable networks.[54] Moreover, that financial incentive has been repeatedly reinforced in explicit commitments made by AT&T to the Commission, to AT&T's stockholders and to the public that AT&T will use cable telephony to provide local telephone services to customers in areas served by MediaOne as expeditiously as possible.[55]

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[52] SBC at 51; Hausman Decl. ¶ 36; GTE at 65-66; Bell Atlantic at 57 (any claim that AT&T will not use cable telephony to provide local telephone service "is not credible").

[53] SBC at 51 (emphasis in original). *See also* Hausman Decl. ¶ 36 (stating that to earn the revenues required to recover its multi-billion dollar investment in cable telephony, "AT&T must invest in local telephone competition," and that "[i]f AT&T were to announce that it had decided not to proceed with its local telephone competition investment plan, AT&T stock would decrease almost immediately by about 25%. Thus, AT&T will be required by the stock market to compete in local telephone markets"); Ordover/Willig Decl. ¶ 33.

[54] *See AT&T-TCI* ¶ 148 ("Based on our analysis of the assets and capabilities of the merging firms, this combination is likely to be profitable only if AT&T-TCI's plans for upgrading the cable systems and, where economical, introducing telephony and broadband Internet access, are carried out").

[55] *See, e.g., id.* ¶ 148 & n.436; Public Interest Statement at 3, 20; Armstrong, AT&T Midyear Report to Stockholders, August 1999 <www.att.com/ir/> ("We are committed to leading the industry into a new generation of communications, information and entertainment services [using] the cable box on your television set [to provide] consumers . . . a choice for local phone service and prices [that] will be lower"). There is no inconsistency between AT&T's position in
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SBC's further claim that AT&T's commitments cannot be trusted because AT&T did not "live up to" its prior "commitment" to the Commission that @Home customers would not have to go through @Home or view any @Home-provided content or screens (SBC at 49) is simply wrong. As explained *infra*, it remains true today, as it was true when AT&T made the statement in the TCI merger application quoted by SBC, both that @Home customers are free to bypass @Home-provided content or screens and that many customers actually do so today.[56]

Finally, there is no basis for Bell Atlantic's novel theory that the increased competition resulting from the Merger should be counted as a public interest benefit only if AT&T "promises" to offer plain old telephone service ("POTS") over MediaOne's cable network, unbundled from other services such as cable television or high-speed Internet access.[57] As the Commission has already found, competitive entry from cable telephony, in whatever form it takes, clearly benefits consumers by offering them more competition and more options than they currently have.[58] Further, although there is no conceivable basis in law and economics to impose

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(. . . continued)
this proceeding, and AT&T's proposal in the SBC-Ameritech merger case that, if approved at all that the merger should be conditioned on written commitments from SBC and Ameritech to carry out their promised future entry into out-of-region local markets. *See* SBC at 49. Out-of-market entry is peripheral to the business plan of SBC and Ameritech, and the merger applicants obviously proposed it only as a sop to help win Commission approval of the underlying transaction. SBC has no incentive to engage in out-of-market entry absent a condition requiring it to do so: if it shirks its commitment after obtaining regulatory approval of the Ameritech merger, it gets a bigger monopoly and eliminates a competitor. By contrast, AT&T and MediaOne's planned expansion into cable telephony and Internet services is the linchpin of their post-Merger business plan and is critical to the commercial success of the Merger.

[56] *See, e.g.*, Declaration of Susan Marshall ¶¶ 3-4 ("Marshall Decl.").

[57] Bell Atlantic at 57-59.

[58] *See, e.g., AT&T-TCI* ¶¶ 146-148; *accord*, Ordover/Willig Decl. ¶ 49.

dominant carrier unbundling obligations on a new entrant, both AT&T and MediaOne *are* offering POTS service over cable facilities today. The problem for Bell Atlantic and its ILEC brethren – and the reason they seek here to raise AT&T's costs with unnecessary regulation – is that where AT&T and MediaOne are offering POTS service to mass market consumers, the prices for AT&T and MediaOne services are much lower than the incumbents' prices.[59]

In sum, the Commission can be quite confident that the public interest benefits identified by Applicants are both real and substantial. In this regard, opponents of the Merger offer the Commission a choice. The Commission may either trust the unsupported claims of those that have the most to gain from ensuring that competition does *not* develop, or reaffirm what the Commission held just last year: that AT&T's cable-based entry strategy of combining complementary assets – backed by AT&T's unprecedented commitment of $100 billion of its shareholders' resources – not only creates the best prospect for mass market local telephony competition but promises substantial additional public interest benefits as well. The choice is obvious. Indeed, the opponents' own anticipatory competitive responses to the mere prospect of competition from AT&T confirm that the merger opponents' speculation is backed only by hollow rhetoric and that this Merger will indeed serve the public interest.

II. THE MERGER WILL HAVE NO SIGNIFICANT ANTICOMPETITIVE EFFECT IN ANY MARKET.

The Merger threatens no harm to consumers or competition in any relevant market. As explained above, however, the Merger poses a very *real* threat to the dominant providers of local telephony and online services. For that reason, the ILECs and AOL have gone to great lengths to

[59] *See* McGee Decl. ¶ 7.

manufacture competitive "harms." As detailed below, there is no merit to these claims, each of which takes great liberties with the relevant facts, fundamental economic principles or both. In each case, the goal is the same: to sabotage the increased competition that the merger promises. As ILEC and AOL executives recently, and perhaps a bit too candidly, remarked of their unholy alliance: our "big idea? Get the feds to hobble AT&T in the name of 'consumer choice.'"[60]

A. The Merger Will Have No Material Impact In The Video Programming Market.

1. The Merger Will Not Materially Impact Video Programming Concentration.

Competition in the video programming business is exploding.[61] There are currently over 245 national satellite-delivered video services, up from 172 in 1997.[62] Many of these are owned by large, well-funded and experienced media companies. And of the 245 national services, 61 percent are not owned by *any* MSO.[63] Furthermore, the Commission has identified 65 planned national programming services that are expected to launch in the near future.[64] The proposed Merger will have no anticompetitive effects in this highly dynamic market.

Recognizing this, Opponents concoct an entirely different (and imaginary) merger to challenge. More specifically, Consumers Union ("CU") and Bell Atlantic contend that this Merger somehow combines all the programming interests held by AT&T, MediaOne, Liberty

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[60] P. Kiger, *George Vradenburg's Potomac Fever*, Regardie's Power, at 85 (Sep./Oct. 1999).

[61] Public Interest Statement at 44-45.

[62] Fifth Annual Report, *Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming*, FCC 98-335, ¶ 159 (rel. Dec. 23 1998) ("*Fifth Annual Video Competition Report*").

[63] *Id.*

[64] *Id.* ¶ 168.

Media Group ("Liberty"), TWE, and Cablevision.[65] As demonstrated below and in the attached report by Charles River Associates, that claim is indefensible.[66]

AT&T neither controls nor has an economic interest in Liberty. Liberty's programming interests thus do not and cannot increase AT&T's power – whether pre- or post-Merger – in the video programming business. Moreover, AT&T's post-Merger ownership interests in the video programming held by TWE and Cablevision will be only passive economic interests that give AT&T no programming involvement.[67] Any economically meaningful measurement of market concentration must reflect differences between control and mere economic interest: although the investor may alter its *own* behavior as a result of the acquisition of a mere economic interest in another firm, the investor cannot directly affect the behavior of the firm itself.[68] These facts make clear that the Merger will have no material impact on video programming concentration. Opponents simply ignore them.

a. AT&T's ownership of Liberty does not affect AT&T's incentive or ability to act in an anticompetitive manner.

Unable to point to any basis in logic or economic theory, Opponents resort to mischaracterizing statements of the Commission and Department of Justice ("DOJ") to support

[65] Bell Atlantic at 2-6; Consumers Union, *et al*, *Breaking the Rules: AT&T's Attempt to Buy a National Monopoly in Cable TV and Broadband Internet Services*, at 52-55 ("Cooper Report").

[66] S. Besen, S. Moresi & J. Woodbury, *An Economic Analysis of the Effects of the AT&T-MediaOne Merger on Competition in the Supply and Distribution of Video Programming Services: Response to the Critics* ("CRA Report").

[67] MediaOne's remaining programming interests are very limited. *See* Public Interest Statement at 17.

[68] *See* CRA Report at 7-8.

their assertion that AT&T controls and has an economic interest in Liberty.[69] But, as Professor Coffee explains in his supplemental declaration, the fact that the Commission and DOJ have stated that Liberty is in some sense a "subsidiary" of AT&T, and that AT&T has an attributable interest in Liberty for purposes of the program access rules, does *not* mean that AT&T has an "economic" interest in Liberty that would create an incentive for AT&T to act anticompetitively toward unaffiliated programmers or competing MVPDs. AT&T's ownership of Liberty has been structured to ensure that: (1) Liberty and AT&T are, and will remain, economically distinct entities; and (2) Liberty is and remains operationally independent from AT&T. Thus, any anticompetitive action that AT&T might take to benefit Liberty (*e.g.*, foreclosing video programmers that compete with Liberty) cannot possibly benefit AT&T, because AT&T has *no* right to participate in any increased revenues or value Liberty might realize from such foreclosure.[70] Similarly, Liberty has no incentive to take any action to benefit AT&T (*e.g.*, by refusing to sell programming to an MVPD that competes with AT&T), because Liberty does not participate in AT&T's increased revenues or value. Finally, because AT&T and Liberty are operationally independent, neither can compel the other to take such actions, even if they had incentives to do so.

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[69] *See* Bell Atlantic at 4-5; U S West at 12.

[70] *See* Supplemental Declaration of John C. Coffee, Jr. ¶ 16 ("Coffee Supp. Decl.") ("I do not believe there is any realistic way that AT&T can dominate or control the Liberty board of directors, divest assets or earnings from Liberty to itself, or receive any material economic benefit from its ownership of Liberty. In turn, this implies that, having no economic incentive to control Liberty, AT&T should be rationally indifferent as to the management policies and practices that Liberty follows.").

In short, AT&T's ownership of Liberty is irrelevant to an analysis of AT&T's impact on the video programming market because that ownership does not affect AT&T's incentive or ability to act in an anticompetitive manner.

AT&T and Liberty are economically distinct. The Commission's statement that Liberty is a subsidiary of AT&T is not inconsistent with the fact that AT&T has no economic interest in Liberty. Liberty is a subsidiary of AT&T because AT&T indirectly owns 100 percent of the outstanding capital stock of Liberty Media Corporation ("LMC"), which, in turn, owns substantially all of the assets of Liberty. However, this does not give AT&T an economic interest in Liberty because AT&T's ownership of Liberty has been specifically structured to ensure that the economic interests of AT&T and Liberty are totally separate.[71]

Most importantly, all dividends and distributions by Liberty must be passed through to its tracking stock shareholders, not to AT&T.[72] Thus, AT&T has no ability to participate in any distribution of profits earned by Liberty and will receive no benefit from increasing Liberty's revenues. Moreover, because the value of Liberty's assets are represented by the value of the Liberty tracking shares, any appreciation in the value of Liberty and/or its assets will be reaped by the Liberty tracking stock shareholders, not by AT&T.[73]

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[71] *See* Coffee Supp. Decl. ¶ 16.

[72] The Liberty tracking stocks are *not* held by AT&T (or any of AT&T's affiliates). Rather, the stocks are held by the former TCI-Liberty tracking stock shareholders and others that have purchased the publicly-traded Liberty shares since the merger of AT&T and TCI. *See* Coffee Supp. Decl. ¶ 3.

[73] *See id.* ¶¶ 10, 12-13.

Other constraints on AT&T's ownership of Liberty prevent any indirect participation in Liberty's assets or earnings. For example, AT&T may not "unwind" its ownership of Liberty except by a spin-off to the Liberty tracking stock shareholders, and AT&T cannot authorize new Liberty tracking stock, or dispose of Liberty's underlying assets, without the consent of the Liberty shareholders.[74] This same analysis applies in reverse, *i.e.*, Liberty owns no interest in AT&T and therefore has no incentive to take anticompetitive actions to benefit AT&T.[75]

AT&T cannot compel Liberty to undertake actions to favor AT&T. AT&T and Liberty also lack the means to cause one another to take anticompetitive actions to benefit the other. Indeed, AT&T's relationship with Liberty has been structured to provide Liberty with operational independence from AT&T. The Liberty officers and Board of Directors decide Liberty's course autonomously – without considering the interests of AT&T. For seven years following the Merger, a majority of LMC's board will be individuals who were on the LMC board prior to the Merger (or will be selected by pre-Merger incumbents).[76] Liberty and AT&T can compete with each other in their lines of business and have no obligation to provide financial support, share corporate opportunities, or otherwise assist each other. Likewise, Liberty has complete control over its own financing capability and other corporate matters. In short, Liberty and AT&T are operationally independent entities such that neither company can control the decisions of the other.[77]

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[74] *See id.* ¶¶ 8-9.

[75] *See id.* ¶ 13.

[76] *See* Coffee Supp. Decl. ¶ 12.

[77] *See* Coffee Supp. Decl. ¶ 13.

The DOJ has not found that AT&T controls Liberty. Bell Atlantic is dead wrong when it asserts that "[t]he Department of Justice has . . . found that AT&T controls Liberty."[78] The DOJ in its Competitive Impact Statement regarding the AT&T-TCI merger observed that "Liberty will be a wholly-owned subsidiary of AT&T Corp." This statement, while true, does not mean that AT&T *controls* Liberty. As shown above, ownership is not the same as control, and AT&T has no ability to control Liberty. The DOJ recognized as much. In its Competitive Impact Statement, DOJ noted that the relationship between AT&T and Liberty promoted a "hold separate" relationship justifying an extended divestiture period for Liberty's Sprint PCS interest.[79] Thus, far from concluding that AT&T controls Liberty, the DOJ has properly recognized that the operations of Liberty and AT&T are separate (and the consent judgment requires that this separation remain in place).[80]

b. This is not a merger of TWE and Cablevision.

CU's claim that the Merger is a complete merger of AT&T, MediaOne, TWE, and Cablevision is likewise unfounded.[81] AT&T's post-Merger interests in the programming services of TWE and Cablevision are only partial economic interests and AT&T will have no involvement in programming decisions.[82]

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[78] Bell Atlantic at 5.

[79] *See* Competitive Impact Statement at 12-13, *U.S. v. AT&T Corp.*, No. 1:98CV03170 (D.D.C. filed December 30, 1998).

[80] *See* Coffee Supp. Decl. ¶ 14.

[81] *See* Cooper Report at 54.

[82] To the extent CU suggests that Comcast's programming interests are relevant here, Cooper Report at 54, this claim should be rejected out of hand. AT&T's agreement with Comcast pertains only to cable system swaps. Moreover, the ultimate arrangements by which certain cable systems will be swapped between Comcast and AT&T following the closing of the Merger
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There is ample reason for treating AT&T's post-Merger minority limited partnership interest in TWE as a silent interest for measuring concentration in the video programming marketplace.[83] This is so because Time Warner manages the day-to-day operations of TWE, and Time Warner's representatives to the TWE Board can take action unilaterally, without consent or participation by MediaOne, or even notice to MediaOne.[84] "AT&T and MediaOne simply do not have the power to control decisions, policies, or practices of TWE, and, indeed, have no involvement in day-to-day management of TWE cable operations."[85]

Additionally, MediaOne's August 3, 1999 termination of a noncompete clause between MediaOne and TWE, triggered a provision of the TWE partnership agreement that further limits MediaOne's – and therefore AT&T's post-Merger – rights. As described in Time Warner's recent filing to the SEC:

> As a result of the [non-compete] Termination Notice and the operation of the Partnership Agreement governing TWE, *MediaOne's governance and management rights have*

(. . . continued)
have not been determined, and no application for such transfer is before the Commission in this proceeding or elsewhere.

[83] Equally important, the acquisition does not increase AT&T's interest in the Time Warner program services that are held outside TWE, most importantly the Turner services (for example, CNN, TNT, and the Cartoon Network). CU, however, attributes these interests as well to AT&T.

[84] *See generally* Declaration of John C. Coffee, Jr. ("Coffee Decl."). MediaOne has never participated in a Board meeting, and, to the best of MediaOne's knowledge, the TWE Board has never met. Post-Merger, AT&T will have the right to appoint two of six members to the TWE Board. However, the two AT&T board members will amount to nothing more than the means by which AT&T will be allowed to exercise certain rights designed to protect its minority investment in TWE. In fact, as described below, these protective rights are consistent with those the Commission generally permits for insulated limited partners and in no way implicate involvement with TWE's programming or other assets.

[85] Coffee Decl. ¶ 27.

terminated immediately and irrevocably to the fullest extent permitted by Section 5.5(f) of the TWE Partnership Agreement. As a result, *MediaOne no longer has a vote on or any right to participate in the Cable Management Committee* described on page I-21 of TWE's Annual Report on Form 10-K for the year ended December 31, 1998, *and its representatives serving on TWE's Board of Representatives no longer have the right to vote on any matter pertaining to any of TWE's businesses.* MediaOne retains certain protective governance rights on the TWE Board of Representatives pertaining to certain limited matters affecting TWE as a whole.[86]

In other words, Time Warner will bring matters to the attention of AT&T's representatives on the TWE board only when such matters fall within the scope of AT&T's very limited investor rights, which, as Professor Coffee explains, are characteristic of a limited partner with no control.[87]

In fact, because AT&T post-Merger will not be involved, directly or indirectly, in the management or operation of the media-related activities of TWE, AT&T believes that its interest satisfies the Commission's requirements for an insulated limited partnership. The Commission has enumerated seven factors[88] that will ensure that a limited partnership interest is insulated.[89]

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[86] Time Warner Entertainment Company, L.P., Securities and Exchange Commission Form 8-K (filed Aug. 5, 1999), at 3 (emphasis added).

[87] *See* Coffee Decl. ¶ 27.

[88] *See* 47 C.F.R. § 76.501, note (g)(2) (*citing* Memorandum Op. and Order, *Reexamination of the Commission's Rules and Policies Regarding the Attribution of Ownership Interests in Broadcast, Cable Television and Newspaper Entities*, 58 Rad. Reg. 604 (1985), *as modified on reconsideration*, Memorandum Op. and Order, 1 FCC Rcd. 802 (1986)). Specifically, the partnership documents should: (1) specify that the exempt limited partner cannot act as an employee if his functions relate to the partnership's media enterprises; (2) bar the exempt limited partner from serving, in a material capacity, as an independent contractor or agent regarding the partnership's media enterprises; (3) restrict the exempt limited partner from communicating with others regarding the day-to-day operations of the partnership's business; (4) empower the general partner to veto the admission of additional partners admitted by the exempt limited partner; (5) prohibit the exempt limited partner from voting on the removal of the general partner, or limit this right to situations where the general partner is subject to bankruptcy proceedings, adjudged incompetent by a court, or is determined incompetent by an independent third party; (6) bar the exempt limited partner from performing services to the partnership that relate to the partnership's

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The facts provided above demonstrate that the post-Merger rights and activities of AT&T with regard to TWE conform to these seven factors, and thus AT&T's post-Merger interest in TWE will be adequately insulated for purposes of the Commission's attribution rules.[90]

Specifically, the approval rights that MediaOne has – and AT&T will have after the Merger – are limited to fourteen items, all of which are consistent with an insulated limited partnership interest.[91] The Commission has found that the inclusion of all of these approval rights in either corporate or LLC documents does not lead to a finding of attribution.[92] In particular, the Commission has ruled that "[t]he right to participate in matters involving extraordinary corporate actions . . . does not ordinarily undermine the nonattributable character of otherwise noncognizable interests, so long as the voting rights or licensee obligations are

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media activities, with the exception of loaning money or acting as a surety for the partnership; and (7) state, in express terms, that the exempt limited partner is prohibited from becoming actively involved in the management or operations of the partnership's media businesses. *Id.*

[89] While limited partners generally will be adequately insulated if the partnership documents address the seven insulation criteria, a limited partner can demonstrate insulation when the attribution criteria are not specifically delineated in the limited partnership agreement. *See, e.g.*, Memorandum Op. and Order, *Application of Sacramento RSA Limited Partnership*, 9 FCC Rcd. 3182, ¶ 12 n.18 (1994).

[90] It is important to note that the foregoing analysis regarding the *de minimis* impact of AT&T's interest in TWE vis-a-vis a video concentration analysis does not depend on the Commission concluding that AT&T's interest in TWE qualifies as an insulated limited partnership interest.

[91] *See* Coffee Decl. ¶ 18.

[92] *See* Memorandum Op. and Order, *Applications of Roy H. Speer, Transferor, and Silver Management Company, Transferee*, 11 FCC Rcd. 14147, ¶ 18 (1996); *see also* Memorandum Op. and Order, *Applications of Quincy D. Jones, Transferor, and Qwest Broadcasting, LLC, Transferee*, 11 FCC Rcd. 2481, ¶ 9 (1995) ("*Jones-Qwest Order*").

narrowly circumscribed."[93] AT&T's approval rights post-Merger are the very type of narrowly circumscribed shareholder rights that are permitted under the Commission's attribution criteria.

Finally, AT&T's interest after the Merger in certain cable programming entities that sell programming to TWE should not disrupt the insulation of AT&T's interest in TWE; as demonstrated above, Liberty operates independently from AT&T. Liberty's sale of programming to TWE should not in any way be considered a sale by AT&T to TWE because AT&T literally has nothing to do with (and derives no economic benefit from) any such sale.

Similarly, the sale of programming by Rainbow to TWE should not affect AT&T's insulation in the TWE partnership, because AT&T in no way controls Rainbow. AT&T holds a 33 percent equity investment in Cablevision, which, in turn, owns 75 percent of Rainbow, with the remaining 25 percent held by NBC Cable. AT&T's interest in Cablevision is held only through Class A common shares. The supervoting Class B shares held by the Dolan family and trusts in favor of certain Dolan family members reduce AT&T's voting power to approximately 8.9 percent. AT&T has the right to nominate two of the total 15 members of the Cablevision Board. However, the Class B shareholders are entitled to elect 75 percent of Cablevision's Board. Through their Class B shares, the Dolan family and certain trusts in favor of members of the Dolan family control the Cablevision Board. Thus, Cablevision (and the Dolan family), not AT&T, controls the Rainbow programming services. If Rainbow sells programming to TWE, it does not do so at the direction of AT&T.[94]

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[93] *Jones-Qwest Order* ¶ 29.

[94] In a recent Order, the Commission indicated that "a contractual arrangement to provide programming would be inconsistent with the insulation criterion that 'the limited partner may not perform any services for the partnership materially relating to its media activities,'" and therefore would not allow insulation of the limited partner's interest. Regardless of the merits of that (continued . . .)

c. **MediaOne does not manage or control any programming.**

MediaOne also controls no programming. For example, MediaOne owns a 5.5 percent interest in The Food Network, which is controlled by Scripps; a 10.4 percent interest in E! Entertainment Television, which is controlled by Comcast and Disney; and a 14.62 percent interest in the Sunshine Network, which is controlled by News Corporation. In addition, MediaOne holds non-controlling interests in four other programming partnerships in which no single entity owns a majority of the partnership interests. MediaOne does not manage any of these programming entities, let alone have the ability to control or compel any actions taken by them. Under such circumstances, it makes no sense to view a sale of programming by these entities as a sale by MediaOne – or AT&T post-Merger.

d. **The limited economic interest AT&T is acquiring in video programming raises no competitive concerns.**

As noted above, AT&T currently does not control – or have any economic interest in – Liberty programming, and AT&T will not gain the ability to control any significant programming from its acquisition of MediaOne. AT&T will gain *no* ability to dictate what programming these entities develop, or to whom and at what price these entities sell programming.

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decision, however, the sale of programming to TWE by Liberty, Rainbow (a subsidiary of Cablevision), and the video programming providers in which MediaOne holds an interest should not be equated with the sale of such services by AT&T itself. Simply put, the sale of programming to TWE by an entity that is not the "alter ego" of AT&T does not involve AT&T in the media-related business of TWE in any material sense. Report and Order, *Review of the Commission's Regulations Governing Attribution of Broadcast and Cable/MDS Interests*, FCC 99-207, ¶ 133 (rel. Aug. 6, 1999) (citation omitted).

Accordingly, Opponents' Herfindahl-Hirschman Index ("HHI") calculations[95] – which treat these economic interests as full control – make no economic sense. Rather, as set forth in detail in the accompanying CRA Report, unlike control, the limited, silent ownership interests AT&T will acquire through this Merger have, at most, only a very slight – and, here, immaterial – impact on its pricing incentives.[96] While the HHI analyses undertaken by Opponents cannot account for the difference between full control, partial control, and silent financial interest, the modified ("MHHI") analysis set forth in the CRA Report conservatively reflects these factors.[97] And this analysis makes clear that the proposed Merger poses no threat of undue concentration in the video programming marketplace.

This is true whether the relevant market is defined to include basic and premium cable programming services or premium services only. If the relevant market is defined to include basic and premium video programming services, the Merger increases the MHHI by only 48.[98] If the relevant market is defined to include only premium video programming services, there is *no* alteration of the MHHI, because AT&T does not at present own any interests in premium services.[99] Thus, as demonstrated in the CRA Report, the proposed Merger does not result in

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[95] *See* Cooper Report at 54.

[96] CRA Report at 12-15.

[97] *See id.* Appendix A.

[98] *See* CRA Report at 13 & Table 1.

[99] This same result is obtained if the relevant market is defined to include only premium video programming services except Encore because, as noted above, AT&T does not currently own any interests in premium services. Encore could be excluded from premium services because it typically offers second-run movies as compared to the first-run movies and similar programming offered by premium services such as Showtime and HBO.

any material increase in concentration of the video programming business, and the change in concentration resulting from the Merger "is only a small fraction of that estimated by [CU]," and presents little competitive concerns.[100]

2. The Merger Will Not Give AT&T Monopsony Power or Vertical Foreclosure Power.

In the Public Interest Statement, Applicants demonstrated that there is no basis in economics, established antitrust law, or experience to credit claims that this Merger will confer on AT&T monopsony or vertical foreclosure power over unaffiliated video programmers.[101] Post-Merger, AT&T will purchase programming or be involved in programming decisions for cable systems that serve only about a quarter of current MVPD subscribers.[102] There can be no credible claim that AT&T will have power over price or significantly raise rival programmers' costs when they can reach *three fourths* of their potential U.S. customers through other MVPDs, whose programming decisions will be uncontrolled and uninfluenced by AT&T. As the Commission has already recognized, the "over 50 million subscribers" served by other U.S.

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[100] CRA Report at 15. Moreover, even if Liberty were owned and controlled by AT&T for the purpose of a video concentration analysis (which is emphatically not the case), the Merger would increase the MHHI for the cable programming marketplace by at most 104 points, one tenth of the change in the HHI estimated by CU. As noted by CRA, "the competitive effects of these small increases in concentration, even if they were empirically important, could likely be easily offset by the entry of new program services (including additional services from existing providers)." *Id.* at 14. These calculations assume that AT&T's interest in TWE. If one assumes that AT&T has proportional control over TWE following the Merger, then the change in the MHHI is even smaller. *See id.* at 14, n.18.

[101] Public Interest Statement at 54-60. *See also* Declaration of Madison Bond ¶ 20 ("Bond Decl.") (Statement of AT&T's Executive Vice President for Programming that he has "been advised that AT&T ... receives no economic benefit from Liberty Media success, and [he] act[s] accordingly.").

[102] *See* Public Interest Statement at 55-56.

cable companies are alone "well over the threshold for national success"[103] under even the most extravagant estimates that "success" requires 15 to 20 million subscribers.[104] Moreover, the presence and success of DBS providers – with their national coverage and 10 million strong (and rapidly growing) subscriber base – removes any doubt that an attempt by AT&T to mistreat programmers would be not merely futile, but suicidal. Any cable company foolish enough to attempt that would succeed only in driving its intended "victims" into the arms of its DBS competitors, who would be all too happy to embrace spurned but desirable programming – and ultimately the cable company customers that are attracted to that programming.

It should therefore come as no surprise that not a single video programmer filed comments in this proceeding. Moreover, the ILECs and others that purport to champion programmers' interests simply disregard the facts. Their principal claim is that AT&T has the numbers wrong, and that rather than focusing on the relevant criterion – the share of subscribers for which AT&T will purchase programming or be involved in programming decisions – the Commission should instead look to the "homes passed" and "cable-only" criteria that it has already tentatively rejected as a measure of cable MSO power over programmers.[105] Tellingly, the LECs could not muster a single economist to support that approach. To the contrary, the

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[103] Memorandum Op. and Order on Reconsideration and Further Notice of Proposed Rulemaking, *Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992, Horizontal Ownership Limits*, 13 FCC Rcd. 14462, ¶ 45 (1998) ("*Horizontal Ownership Further NPRM*").

[104] *See, e.g.*, Ameritech at 35. That the 15-20 million figure is unquestionably too high is confirmed by the commercial success of many video programming services with far fewer subscribers. *See, e.g.*, TCI Horizontal Ownership Comments at 76-77.

[105] *Further NPRM* ¶ 76.

only economic affidavit they chose to submit on the subject acknowledges that the focus must be on "subscribers" for which AT&T has "control over buying decisions for cable programming content" and on "alternative buyers" of video programming.[106]

The ILECs nonetheless declare that "new channels would be foreclosed from reaching almost two-thirds of the market if AT&T/MediaOne, for whatever reason, refused their request for carriage."[107] That is patently false. Even under a static analysis, a service that AT&T absolutely refused to carry would still have access to MVPDs that serve three-fourths of all U.S. subscribers. And, as noted above, that static view vastly *overstates* AT&T's position under any dynamic analysis that properly recognizes that a cable company's refusal to carry programming its customers want simply sends those customers to the cable company's DBS and other competitors.[108]

SBC claims that because DBS competition does not constrain cable's "power" over *consumers*, the Commission can ignore the obvious constraint DBS providers place on cable's "power" over *programmers*.[109] Even if the premise were true, the conclusion would not follow.

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[106] *See* Hausman Decl. ¶ 11, 14, 22. *See also* CRA Report at 22-23.

[107] GTE at 13.

[108] *See, e.g.*, CRA Report at 24-25; Bond Decl. ¶ 5. SBC "questions the Commission's conclusion in the *1998 Annual Competition Report* that no single cable operator or pair of cable operators is large enough to block entry by a new programmer," SBC at 27, on the basis of Professor Hausman's statements that programmers "will produce lower quality programming" and "may decide to forgo entry altogether" *if* "rates are depressed below competitive levels." Hausman Decl. ¶ 19. But that begs the relevant question whether subscription rates will, *in fact*, be depressed below competitive levels – *i.e.*, whether the cable company in question will have monopsony power. *See, e.g.*, CRA Report at 18-27. As explained above, the facts shown in this proceeding (and those relied upon by the Commission in the *1998 Annual Competition Report*) demonstrate that the answer to *that* question is no.

[109] SBC at 21; Hausman Decl. ¶ 9.

Indeed, even if one were to assume (counterfactually) that cable and DBS were not substitutes *at all* and served entirely distinct customer bases, DBS providers – which clearly *buy* from the same video programmers – would nonetheless remain alternative programming *outlets*, whose existence would fully constrain the ability of a cable MSO to squeeze programmers on price.

In any event, the premise is false.[110] As the Department of Justice has observed:

> Cable and DBS are both MVPD products. While the programming services are delivered via different technologies, consumers view the services as similar and to a large degree substitutable. Indeed, most new DBS subscribers in recent years are former cable subscribers who either stopped buying cable or downgraded their cable service once they purchased a DBS system.[111]

And, as the Commission recently emphasized, "the degree of . . . competition" between the two can only "increase"[112]; *two out of every three* new MVPD subscribers choose a DBS operator over the local cable operator.[113]

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[110] *See, e.g.*, CRA Report at 16-18.

[111] Complaint, *United States v. Primestar, Inc.*, No. 1:98CV01193, ¶ 63 (D.D.C. May 12, 1998).

[112] Order and Authorization, *Application of MCI Telecommunications Corp., Assignor, and Echostar 110 Corp., Assignee*, FCC 99-109, ¶ 19 (May 19, 1999) (emphasis added) (citing DOJ's comments filed in that proceeding) ("*Echostar Order*").

[113] *Fifth Annual Video Competition Report* ¶ 62. Moreover, the DBS subscriber base is growing *over 20 times faster* than the cable subscriber base. *Id.* ¶ 12. As the CRA Report explains (at 17), Professor Hausman is plainly wrong in suggesting that the mere *direction* of recent cable and DBS rate changes undermines the conclusion that consumers view DBS as a substitute for cable. As the Commission has recognized, and as Hausman admits in a footnote, cable rate increases reflect sky-rocketing programming costs (that themselves belie any notion that programmers must be protected from cable companies). And Hausman simply ignores the most obvious explanations for declining DBS prices – *e.g.*, declining equipment costs and an exploding customer base across which to spread fixed costs. Likewise, the "high upfront costs" and "lack of local stations" cited by Hausman as DBS handicaps are already (in the case of former) or will soon be (in the case of the latter) relics of the past, and, in all events, have not stopped two out of three new customers from preferring DBS over cable. Likewise, the fact that cable prices are lower in overbuilt areas does not mean that DBS does not impose constraints on
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SBC next speculates that even if video programmers have far too many alternative outlets to fall prey to AT&T alone, AT&T might collude with other cable companies to drive down programming prices or foreclose disfavored programming.[114] Even ignoring SBC's failure to provide a shred of evidence that this Merger will encourage such patently unlawful conduct, the civil and criminal antitrust laws and authorities have proven quite capable of dealing with price-fixing and other cartel behavior of the kind that SBC hypothesizes. And SBC is certainly wrong in asserting that a risk of "coordination" among MSOs distinguishes this case from the many precedents holding that arrangements that create a buyer of less than 35 percent of the input in question do not even merit review. The Department of Justice has routinely applied that "safe harbor" to cases involving coordinated purchases by unaffiliated providers.[115] Indeed, the safe harbor is so low precisely *because* it is designed to allay both unilateral and coordinated conduct concerns. Consistent with the underlying theory that a successful monopsony or foreclosure strategy must leave suppliers no alternative but to deal with the putative monopsonist, the courts have consistently found that much higher market shares are a prerequisite for the ***unilateral*** exercise of market power, particularly where, as here, the sellers are sophisticated, large corporations.[116]

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cable prices; it simply means that additional entry has, on occasion, caused prices to fall further. *See* CRA Report at 17.

[114] Hausman Dec. ¶ 12 n.19; *cf.* CRA Report at 22 (explaining why Hausman's "tacit joint bargaining" theory makes no economic sense).

[115] *See* Public Interest Statement at 57 & n.141 (citing letters).

[116] *See* Public Interest Statement at 57-58 & nn.142-143 (citing cases). GTE badly mischaracterizes *Twin City Sportservice, Inc. v. Charles O. Finley & Co.*, 676 F.2d 1291 (9th Cir. 1982). That case had nothing to do with monopsony power, and the district court's holding that a 24 percent share was "*not* sufficient to support an actual monopolization claim," was not even
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